Statement by

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Secretary-General of UNCTAD
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To the International Monetary and Financial Committee
and the Development Committee

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Chairman Boutros-Ghali,
Chairman Carstens,
Excellencies,
Ladies and Gentlemen

A growing consensus is emerging in the international community on the need for expeditious and
determined policy responses to stem the collapse of global demand. Equally the urgency for specific
measures to help the most vulnerable countries and people is widely acknowledged. But beyond that, the
systemic failures in global finance and in international economic governance call for bold and long term
solutions and a profound rethinking of the global framework for financial regulation and macroeconomic
management, including the role of the international financial institutions. Indeed, current responses at the
level of the G-20 and the efforts by the United Nations General Assembly signal that the imperative of
multilateral coordination has gained wider recognition. However, there is still no consensus on the
concrete steps that need to be taken to achieve meaningful reform of the international monetary and
financial system. Nor is there full agreement on the scope and depth of the domestic policy responses
that countries should undertake.

Short term policy responses so far portray something of a mixed bag. Most impressive to date has been
the United States fiscal stabilization package, coupled with monetary easing to encourage re-ignition of
the credit markets. Governments of many other countries also recognized the need for stabilizing policies,
but many of them, especially in Europe, have not yet overcome the tendency for fiscal conservatism and
the fear of expansionary fiscal actions.

Meanwhile, some emerging economies are using their fiscal space to boost demand at their end of the
global economy. This may help to contain the negative income and employment effects at home. It may
also help, through the trade channel, generating a demand stimulus for other countries. This shows the
importance of an internationally coordinated expansionary action. However, whether this pattern of
demand-boosting policies will help correct global imbalances in sustained manner is to yet to be seen.

Given the sharp contraction in industrial output in the developed countries, the immediate danger is
deflation. With many prices like those for commodities falling already, an absolute fall of the price level
is unlikely to be avoided. The critical question, however, is whether this marks only a temporary
corrective drop or whether it is the beginning of a longer period of deflation. Should “debt deflation” set
in, it could fuel further painful adjustments as debtors try to improve their financial situation by selling
assets and cutting expenditure, thereby driving asset prices further down, cutting deep into profits of
companies and forcing new debt deflation elsewhere. This scenario justifies aggressive and persistent
monetary and fiscal policies.

Deflation will not cure itself. Debt deflation underpinned by contracting private demand can only be
counteracted by government action. Therefore, the most important task is to break the spiral of falling asset
prices and demand and to revive the financial sector’s ability to provide credit for productive investment
to stimulate real economic growth. Since the market system is not self-correcting with respect to
deflation, governments and central banks have to take active measures to boost demand through interest rate cuts and increases in government spending.

But, some observers are still concerned about the danger of these measures leading to accelerated inflation, allegedly through the channel of “too much money chasing too few goods”. However, to become inflationary in a market economy, “too much money” has to go either through the channel of “too much demand” or “too high costs”, in particular labour costs. However, capacity utilization is at historic lows and unemployment is rising with dramatic speed, which will clearly prevent wage inflation for a considerable period of time. Once the global economy begins regaining normal capacity utilization and employment levels, possibly in a matter of years, not months, it will be possible for central banks to withdraw excess liquidity by selling revalued assets and absorbing excess money supply. Hence, fears that “too much money” or rising government deficits could reignite inflation appear unjustified and could be misleading in the current depressed global economy.

At the multilateral level, replenishment of IMF resources should allow it to help countries that are facing problems in rolling–over their external debt. But, for developing countries, what matters most in their efforts to counter the recessionary effects of the global crisis is not only enlarged access to official finance but also the policy space to undertake expansionary counter-cyclical measures.

Unfortunately, IMF conditionality still tends to compel countries to tighten monetary policy and to curb public spending. In fact, this is the opposite of the policies adopted in United States and other developed countries. Such policy action is likely to make matters worse. This should be a time when the international community seriously begins to rethink its paradigm of national monetary sovereignty in a globalized economy and opens the door for an approach of financial and monetary cooperation that recognizes the macroeconomic policy priorities of developing countries.

Moreover, judging by past experiences, and given the crisis-related budgetary burdens in donor countries, there is a high risk that the flow of official development assistance to developing countries will be reduced drastically. This, coupled with repatriation of foreign capital, the higher cost of and the difficulty of accessing external financing from capital markets, the predicted slowdown of foreign direct investment, sharply reduced export earnings and reduced inflows of workers' remittances will make the recovery process difficult and lengthy. UNCTAD believes that reducing ODA at this particular juncture would be counterproductive not only to the recipient countries but also for donors. Rather than cutting ODA, donor countries should increase aid flows as a part of their stabilization programmes. To go a step further, it may be worthwhile considering a temporary moratorium on official debt: both debtor and creditor countries would probably better served in the current crisis situation if scarcer foreign exchange earnings in the debtor economies can be used for the purchase of imports rather than for debt servicing.

It is likely that the impact of the crisis will linger much longer in developing economies than in advanced economies. There is a risk that the sense of urgency and the proactive policies that are currently implemented may not any longer be seen as necessary the moment signs of recovery are shown in developed economies. This makes it imperative that the monitoring mechanism we have truly reflects the state of the world economy, including trends in developing countries.

The policy responses so far remain peripheral to the core systemic failures that were at the heart of this crisis. This stems from the unwillingness to recognize the impact of unfettered financialization and speculation. There is lingering concern, both among policy makers and within broad swaths of public opinion, that bank bailouts will socialize private losses. Moreover, measures to date pay inadequate attention to the need to regulate the shadow banking system where opacity, illusion of risk-free profits and perverse incentive systems all contributed to the failure of the "modern" financial system, which in too many respects had begun to resemble a casino economy.
The G20 Summit has confirmed that a new spirit of pragmatism in economic policy prevails and we are beginning to see a yearning for multilateral coherence that has been sorely lacking in recent years, indeed decades. The resource commitments already made, including those which entail increasing IMF resources are a recognition of the fact that at such a moment, only the IMF has the machinery to channel resources to the next battle front. Certainly, the availability of such resources cannot be held hostage to the still unsettled debate about voice and participation in the Fund.

It is important to encourage the move away from the old attitude that “if a country is in crisis, it must be its fault” and to acknowledge that developing countries are often innocent bystanders hit by crises that originate at the center of the world’s financial system. In order to face these external financial shocks, developing countries need to be provided with ample liquidity with no strings attached.

Such a change in approach is also likely to address the problems that the IMF is facing on the demand side. Some countries have been reluctant to approach the Fund because they feel that the macroeconomic model that is at the basis of Fund policies is not the right one. The legitimacy problem facing the Fund today is not only due to the fact that several developing countries are underrepresented in its Board, but it is also related to the fact that most potential borrowers have become more and more skeptical with regard to the Fund’s policy advice.

IMF resources are often conditional upon what amount to restrictive fiscal and monetary policies. But the conventional wisdom that has emerged in this current crisis rightly warns that such conditionality would be pro-cyclical and not conducive to the sort of domestic demand stimuli that export-dependent developing countries will need to deploy if they, too, are to play their part in countering the collapsing, or at best stagnant, global demand. If the Fund continues to insist upon the same sort of policy packages as rolled out during the Asian crisis, the increased resources made available may even end up being counterproductive.

The initial multilateral response must be further strengthened with coordinated approaches that go beyond simply providing global liquidity. Better regulation of growth-inducing finance should proceed alongside a frank evaluation of the social costs and benefits and economic risks inherent to more predatory, unproductive forms of shadow finance.

The most important task at hand is to break the spiral of falling asset prices and falling demand and to revive the financial sector’s ability to provide credit for productive investment, to stimulate economic growth and to avoid deflation of prices. The key objective of regulatory reform has to be the systematic weeding out of financial sophistication with no social return. Blind faith in the efficiency of deregulated financial markets and the absence of a cooperative financial and monetary system created an illusion of risk-free profits and licensed profligacy through speculative finance in many areas.

This systemic failure can only be remedied through comprehensive reform and re-regulation that acknowledges the need for a vigorous role by governments working in unison. Contrary to traditional belief, governments are well positioned to judge price movements in those markets that are driven by financial activities and should not hesitate to intervene directly and indirectly whenever major disequilibria are looming.

The growing role and weight of large-scale financial investors on commodities futures markets may affect commodity prices and their volatility. Speculative bubbles have emerged for some commodities during the boom and have burst after the sub-prime shock. Regulators need access to more comprehensive trading data in order to be able to understand what is moving prices and intervene if certain trades look
problematic, while key loopholes in regulation need to be closed to ensure that positions on currently unregulated over-the-counter markets do not lead to ‘excessive speculation’.

The absence of a cooperative international system to manage exchange rate fluctuations has facilitated rampant currency speculation and increased global imbalances. Multilateral or even global exchange rate arrangements are urgently needed to maintain global monetary and financial stability, to avoid the collapse of the international trading system and pro-cyclical policies by crisis stricken countries.

The crisis has made it all too clear that globalization of trade and finance calls for global cooperation and global regulation. But resolving this crisis and avoiding its recurrence has implications beyond the realm of banking and financial regulation, going to the heart of the question of how to revive and extend multilateralism in a globalising world. The United Nations could play a central role in guiding this reform process. It is the only institution that has the universality of membership and credibility to ensure the legitimacy and viability of a reformed governance system. It has proven capacity to provide impartial analysis and pragmatic policy recommendations in this area.

Thank you very much.